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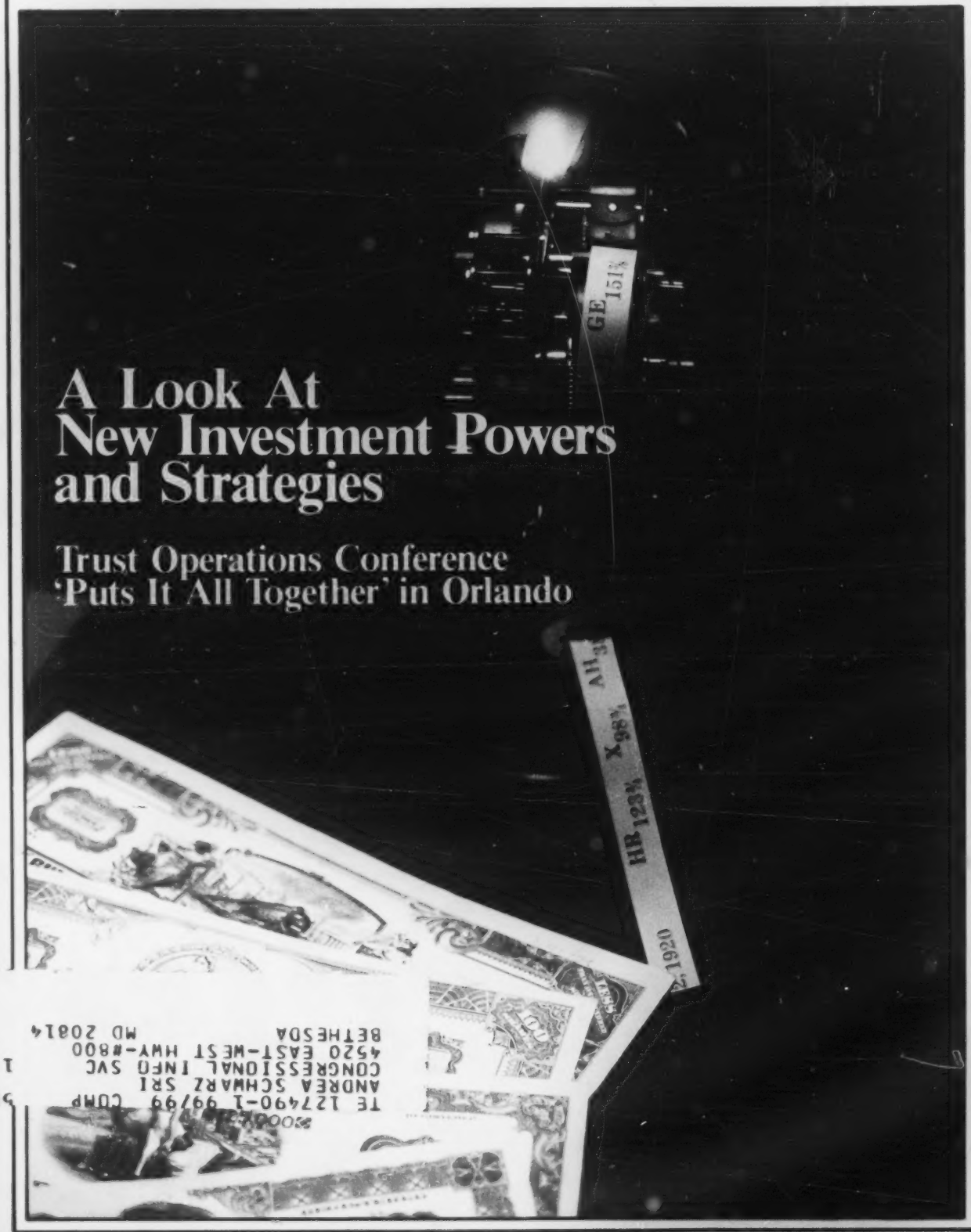

A Look At New Investment Powers and Strategies

Trust Operations Conference 'Puts It All Together' in Orlando

TRUSTS & ESTATES®

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The 25th annual meeting will focus on productivity, profitability and professionalism

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COVER

New investment opportunities have forced trustees and fiduciaries to examine the power of new investments and how they may lessen their risks and increase their returns. Cover photograph courtesy of Jos. Palmieri, AFI Photo Illustrations, Augusta, New Jersey.

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BPA

Commentary

Piecing Together The New Investment Puzzle

Jigsaw puzzles can have 500 pieces, 1,000 pieces or more. This puzzle, the puzzle of achieving success in today's 24-hour, globalized and securitized marketplace has three very important pieces: productivity, profitability and professionalism.

Each will be addressed when the American Bankers Association holds its annual National Fiduciary and Securities Operations Conference this month in Orlando.

In this issue, however, we examine one piece in particular, profitability, under the heading "New Investments."

"The rewards which can be achieved by using non-traditional investment techniques are offset by the significant risk of liability for imprudence if the investment results in a loss to a trust account," according to J. Timothy Ritchie, Trust Counsel for The Northern Trust Co. In his article this month, Mr. Ritchie examines the investment powers granted to a trustee as well as the question of whether they continue to be appropriate in view of new investment opportunities.

Brian R. Bruce, manager of International Equity Products for the Northern Investment Management Company, advises fiduciaries in his article this month not to put all their eggs in one basket. It's a big world out there and, according to Mr. Bruce, international investing in recent years has both lowered risk and increased returns.

Lowering risk is also the focus of an article by Richard C. Taylor, president of Severn Associates, Inc. in Santa Barbara, Calif. In his article he identifies the two types of risks faced by professional investment counselors, business risk and price risk, and discusses how to deal with each.

Also this month, we begin a three-part series on a new multigenerational data base being created by the Internal Revenue Service. The data base, generated from more than 350,000 estate tax returns filed between 1916 and 1945, shows the impact that social and demographic change can have on estate planning. In this first installment, the authors, Janet McCubbin and Jeffrey Rosenfeld, describe the scope of the project and offer a preliminary analysis of the data for the years 1917-1931.

Multigenerational wealth is also the subject of an article by Richard A. Helfand of Arthur Andersen & Co. in Chicago. In his article, Mr. Helfand examines this emerging market in specialized consulting for families who must manage several generations of wealth. In addition to the history of the market, he discusses wealth transfer philosophies, the management of information, the development of a family office, combining family assets and the tax implications of multigenerational planning.

—MSK

Introducing An IRS Data Base For Estate Tax Research

The Intergenerational Wealth Study of 350,000 estate tax returns will show the impact of social and demographic change on estate planning

By **JANET G. MCCUBBIN**
and
JEFFREY P. ROSENFELD
Department of the Treasury
Internal Revenue Service
Washington, D.C.

This is the first in a series of articles describing an Internal Revenue Service ("IRS") data base of interest to estate-planners. IRS is presently creating a data base from estate tax returns. The data base already contains information from more than 350,000 returns, and includes virtually all returns filed between 1916 (the inception of the estate tax) and 1945. IRS will eventually code information from every estate tax return, making this perhaps the most comprehensive electronically accessible archive of data on intergenerational transfers ever compiled.

This article describes the scope of the project, which IRS calls the Intergenerational Wealth Study. There is a preliminary analysis of data for the years 1917-1931 (Data for 1916 have been collected, but most of the tabulations are not comparable to those for other years as the tax was not effective until September). Even at this early stage, the project should be of interest to estate-planners because it shows the impact that social and demographic change can have on estate-planning. For example, the 1917-1931 data show how events like the Great Depression and the First World War are reflected in estate tax returns. Preliminary analysis also suggests that working with an estate-planner was more of a "luxury" than a necessity between 1917 and 1931.

Selected Return Information

As part of this project, the IRS is gathering data not only on portfolio composition, but also on the social and demographic characteristics of decedents and their families; thus, the results from the study can provide far more than a financial accounting of these estates. IRS expects to be able to paint a statistical picture of top wealthholders in America during most of the 20th century. IRS is in the preliminary stages of its data analysis, but is already making some of these findings available to the public. References to publications based on these data appear at the end of this article.

This article may be of special interest to estate-planners because it describes wealthy clients and their portfolios, 1917-1931, and permits inferences about ways that the estate-planning profession has changed since the inception of the estate tax. These insights are possible because three subject areas are consistently being studied for all estate tax returns. These are decedents, beneficiaries, and financial information. A glance at the data coding sheet for this project, which appears in Figure A, shows the kinds of information which have been coded for all 350,000 estate tax returns thus far, and which will be coded for records added to the data base.

Decedents

Standard information for all decedents in the data base includes name, age, date of death, sex, marital status and state of residence. Wherever possible, the data base also includes information on cause of death and occupation. Because an estate tax return must be filed for all decedents with gross assets valued above the annual filing requirement, the data permit a look only at the nation's top wealthholders (see Figure B).

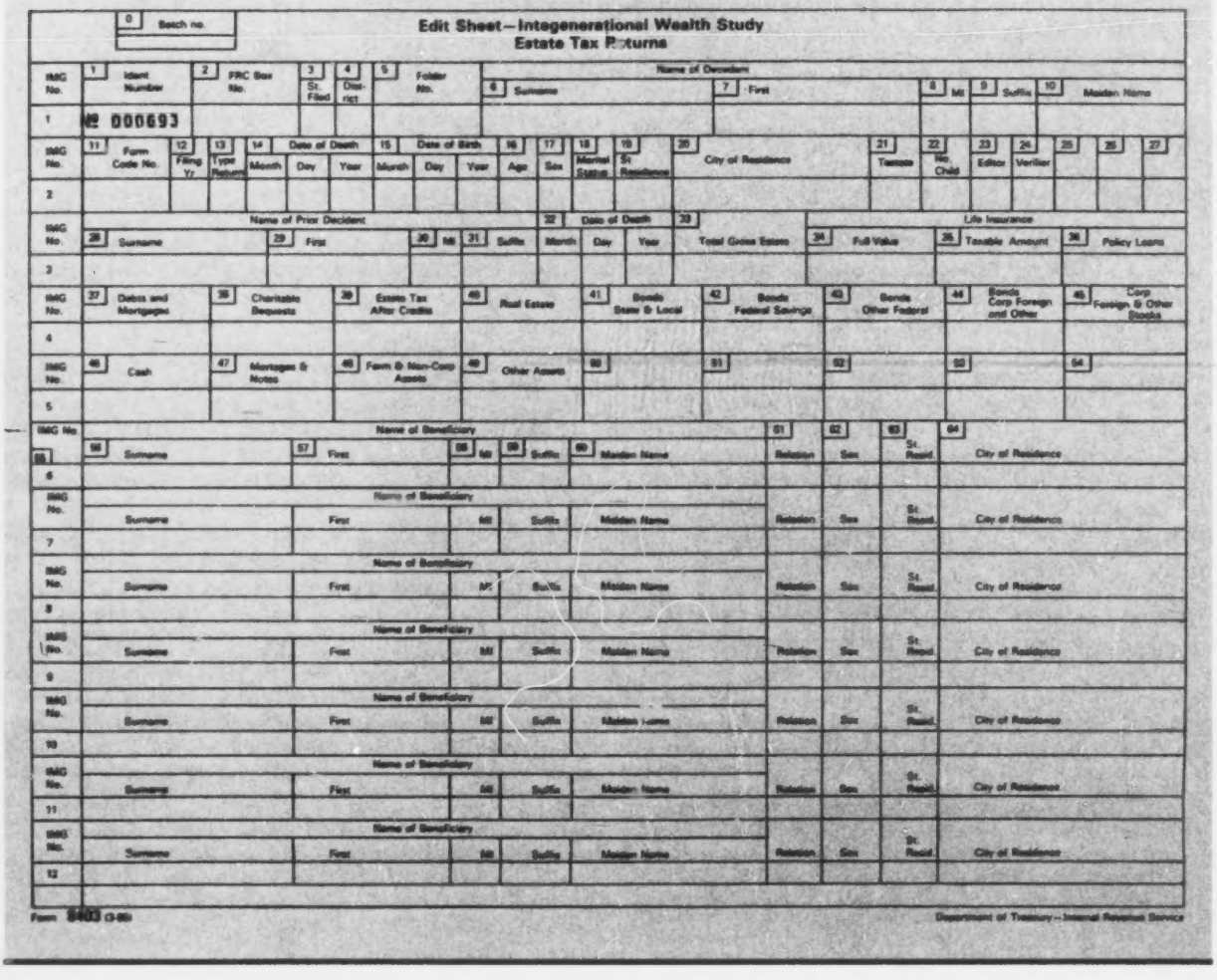
This data base is subject to Federal disclosure regulations which guarantee that no identifying information will ever be made public, thus safeguarding the confidentiality of decedents and their heirs. It is possible, however, to make statistical inferences based on tabulated data. IRS has already analyzed some of the demographic characteristics of decedents who died between 1917 and 1931.

One of the most notable features of this early group is its small size relative to all decedents in the United States between 1917 and 1931. In 1926, for example, estate tax decedents represented .64 percent of all deaths. Form 706 Returns filed in 1986 totaled 2 percent of deaths in the previous year — still a small percentage of all U.S. mortality (returns filed in 1986 are primarily for individuals who died in 1985, returns filed after 1984 have not yet been collated by year of death).

One distinguishing feature of top wealthholders from this period is the proportion of males to females in the group. Male decedents outnumbered female decedents by about 3 to 1; how-

FIGURE A

Sample Data Coding Sheet



Edit Sheet—Integenerational Wealth Study
Estate Tax Returns

ever, the percentage of females did increase from a low of 23 percent in 1919, to 30 percent in 1931. Although there was an increase in the proportion of decedents who were female, the figure for 1931 is still significantly lower than in the decedent population at large. Male decedents have never outnumbered female decedents by this much in the larger population. Incidentally, females comprised about 42 percent of all decedents for whom returns were filed in 1986.

The data indicate that the age distribution of top wealthholders who died between 1919 and 1931 is also quite different from that of the general U.S. population (age was not reported on the estate tax return prior to 1919). Top wealthholders lived longer than decedents in the population at large during this time and women consistently outlived men. From 1919 through 1931, the average age of male decedents was 67 years; female decedents were, on average, 70 years old at their deaths. The average age for all decedents generally increased during the period; however, women achieved greater gains in longevity than did the men, and this trend has continued. The average age of female decedents for whom returns were filed in 1986 was nearly 80, the average age of male decedents was 72.

IRS is studying a sample of top wealthholders even more intensively. The sample includes decedents with a gross estate of $1 million or more. Data on real estate, bonds, corporate stock, cash, notes and mortgages, farm and non-corporate business assets and a category labeled "Other Assets" are collected from the returns filed for these wealthholders. IRS has also intensively studied a sample of about 19,000 decedents with smaller estates, who died during the period 1916 to 1920 and 14,900 who died in 1928 to 1930. Approximately 16,000 decedents who died between 1938 and 1940 and 4,200 who died in 1944 were also sampled for intensive study. IRS will continue with this strategy of intensive study as data collection moves into the 1950's. For example, decedents with smaller estates, who died between 1948 and 1950 will be studied in this way.

In addition to the data on decedents, there are also data on beneficiaries. These include the number of beneficiaries, their relationship to the decedent and their place of residence at the time the estate tax return was filed. Based on beneficiary data, it is possible to learn whether the average number of beneficiaries has increased or decreased

over time, and to identify conditions when wealth passes outside a decedent's family. Estate planners will be interested to learn that the information collected on heirs and bequests will permit the linkage of individuals in successive generations related by kinship and/or economic ties. It will soon be possible to study inheritance patterns by tracing the linkages between beneficiaries and their benefactors.

After IRS has coded all estate tax returns from 1916 to 1966, for example, it will be possible to make these types of connections: Assume that a man dies at age 66 in 1921 leaving his estate *en toto* to his 59 year-old widow. She in turn dies at age 70 in 1932. Her two children, aged 41 and 46, inherit the estate at that time. These offspring die in 1966 and 1970, aged 75 and 84 respectively. Based on those demographics, the data base would first identify this family's wealth in 1921 at the time the husband died. It would resurface in 1932 in his widow's 706 Return, and then in the 706 Returns filed for the offspring in 1966 and 1970, provided that each individual died with an estate worth the filing requirement or more.

Until now, it generally would have been impossible to study intergenerational linkages in a family. But the new IRS data base makes it possible to track wealth within and across generations of kin. The data base will have the capacity to handle complex demographic information, and also the complexities of estate-plans which include trusts and arrangements in which wealth skips generations.

It is also possible to do research on linkages using a relational component inherent in the estate tax law. The term "prior decedent" refers to anyone who made bequests to a decedent within five years of that decedent's death. These prior decedents are identified on the estate tax returns of their beneficiaries. For example, if a beneficiary, Mrs. A dies within five years of receiving a bequest from, say, Mr. A then the value of the bequest from Mr. A may be deducted from Mrs. A's gross estate for estate tax purposes. For this reason, information on Mr. A and his bequest to Mrs. A will be present on Mrs. A's estate tax return. This information can then be used to study the transfer of wealth through at least two stages. At this phase in the study, preliminary work has been performed to create linkages between related estates in the data base. More linkages will be possible when the data base covers a longer period of time. In the later years of the study, it will be possible to link IRS data with other public records that did not exist in the early years.

FIGURE B

Estate Tax Filing Requirement, Current and Constant Dollars

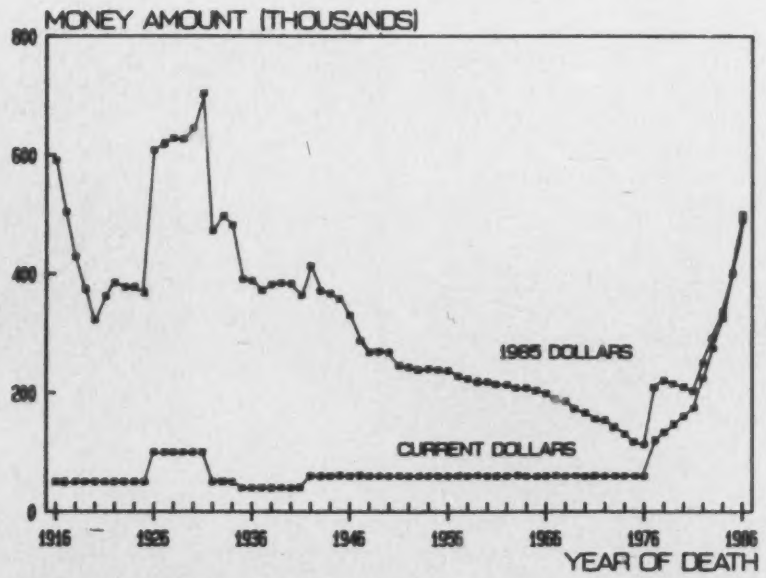
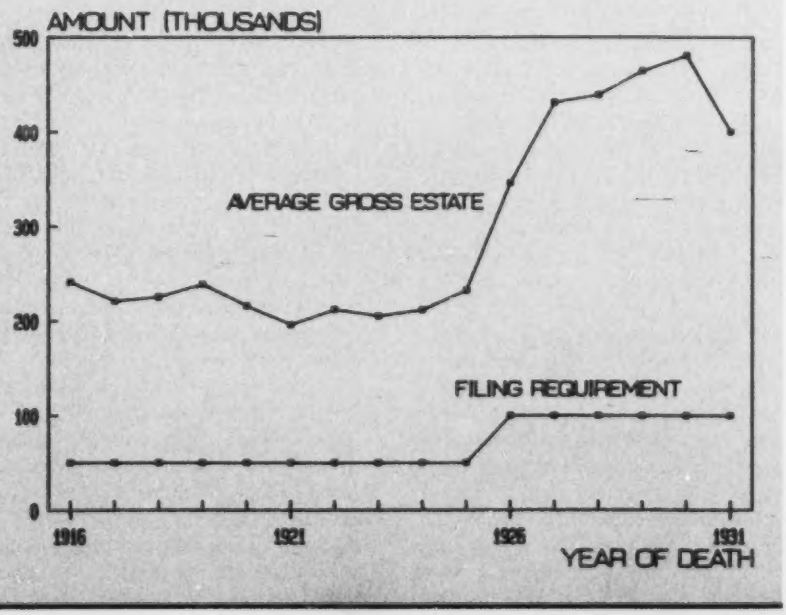


FIGURE C

Filing Requirement and Average Gross Estate, Current Dollars



Financial Information

Apart from data on decedents and their beneficiaries, IRS is also recording data on total gross estate, life insurance, jointly-owned property, debts and mortgages, charitable bequests and estate tax after credits for every return filed since the U.S Estate Tax's inception in 1916 (see Figure C). Using this information, it is possible to make inferences about the operation of the es-

tate tax, the composition of asset holdings, and the characteristics of wealthy individuals in American society. Aggregate wealth estimates and estimates of the distribution of wealth can also be made by applying what is known as the "estate multiplier technique" to these data.[1] As noted in subsection 1, detailed data on portfolio composition are collected from a sample of returns.

Millionaires 1917-1931

Estate-planners will also appreciate what the data base has already been able to say about decedents with gross estates valued at $1 million or more. These decedents, after all, were the wealthy clients of estate-planners during this 15-year period. IRS has already been able to describe the financial portfolio and important social characteristics of these decedents. As a result, estate-planners can learn more about estate-planning practices at the inception of the estate tax and make comparisons to estate-planning practices today. Major events in U.S. 20th century history are reflected in estate tax data for wealthy decedents who died from 1917 through 1931. Both wartime prosperity and the Great Depression, of course, figured prominently during this period.

During the prosperous 1920's, for example, estate tax decedents grew richer. This is reflected in estate tax returns which show that by 1929, 8.2 percent of all estate tax decedents owned assets worth $1 million or more (current dollars). In 1920, only 2.6 percent of decedents had estates with $1 million or more in assets (some of this change was due to an increase in the estate tax filing requirements in 1926). By 1931, however, reported gross estate had declined nearly 30 percent from its all-time high in 1929 and only 6.3 percent of all decedents had assets worth $1 million or more. This reflects the economic impact of the Great Depression.

In 1928 to 1930, on the brink of the Great Depression, the aggregate total gross estate for millionaire decedents (those with at least $1 million in current dollars) were larger than at any time since the inception of the tax in 1916. According to the IRS data, most of their wealth consisted of the corporate stock which would be so seriously affected by the Wall Street crash of 1929. Figure D shows that aggregate corporate stock as a percentage of aggregate gross estate reached a high of 63 percent for 1928 decedents. This is largely attributable to the large increase in stock prices generated by soaring corporate profits between 1921 and 1929. By 1931, holdings in corporate stock had declined to 51 percent of gross assets for millionaire decedents.

Estate planners will also appreciate what the data base has already been able to say about decedents with gross estates valued at $1 million or more.

For these millionaires, bonds were the second most favored investment. Of course, as the portion of the assets held as corporate stock increases, the portion held as bonds generally shows a corresponding decline. This is most notable in 1928, when bonds comprised only 14 percent of all assets for millionaire decedents.

The third most favored investment for millionaire decedents at this time was real estate. The proportion of assets held as real estate varied between 16 percent for 1921 millionaire decedents to 9 percent for 1929 and 1930 decedents. All other assets (including cash, life insurance, and noncorporate business assets) were considerably less important in the portfolios of the millionaire decedents, totaling between 13 and 17 percent of total assets for each year.

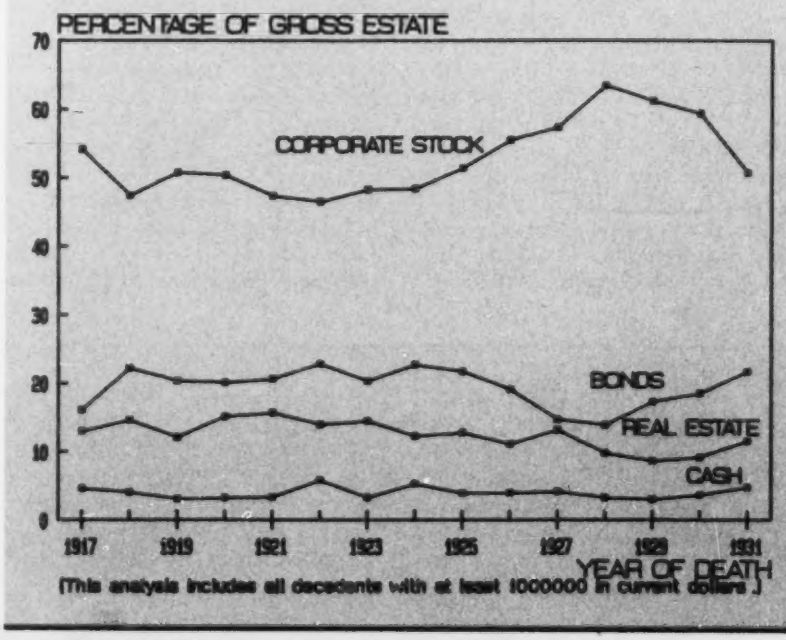
It is also interesting to look at decedents who had at least 1 million in 1985 dollars (for this analysis, all money amounts for 1917 through 1931 were converted to 1985 dollars, using the Consumer Price Index, then the decedents with at least $1 million were studied). The average size of gross estate for these decedents began dropping in 1931. It had hit an all-time high of nearly $4.4 million/decedent in 1930, by 1931 it had fallen to less than $3.8 million/decedent. The year 1931 marks the end of the current analysis, so we will not describe the change in the average value of estates for millionaire decedents after that year; that will be illustrated in our next article. There is, however, information from returns filed in 1986, when the average size of gross estates for millionaire decedents was $2.7 million (recall that returns filed in 1986 were filed primarily for individuals who died in 1985).

From Luxury to Necessity

Even at this preliminary stage, the IRS data base has enough information about decedents to allow inferences about the people who worked with estate-planners after it became necessary

FIGURE D

Millionaire Decedents: Portfolio Distribution of Assets



to file estate tax returns. Who would have sought the services of an estate-planner between 1917 and 1931?

The data suggest that estate-planning was a luxury rather than a necessity, especially between 1917 and 1931. Proportionately fewer people sought the help of estate-planners in the years soon after the estate tax went into effect. The people who wanted this service usually had two characteristics in common: they were usually male, and seem to have been very wealthy (while a larger proportion of the female decedents were testate, many more of the decedents were male, so most clients would have been male). During this period clients generally died younger, and died of acute causes. Not until later would estate-planning be a standard and well-accepted financial service for middle- and upper-income people in the United States. At the inception of the estate tax and for the next 15 years, estate-planners worked mostly with elite clients.[2]

The current data confirm that the client base has changed both socially and demographically. Today's client base includes more women and people from many rungs of the social and economic ladder. These are people who enjoy better health and live longer. Table 1 reflects this demographic fact. In 1931, 53.6 percent of the men and 38.5 percent of the women decedents in the sample had died before the age of 70. By filing year 1986, only 40.2 percent of the men and 16.5 percent of the women had died before the age of 70.

Increased longevity and good health (which are reflected in the Estate Tax Returns being filed in the 1980's) give more people the opportunity to make and remake their estate-plans. The IRS data base will eventually give estate-planners a decade-by-decade picture of this shift, but even now it shows that working with an estate-planner went from being a luxury to being a necessity for wealthy people. The data show that the proportion of top wealthholders dying testate increased steadily over the period. In 1920, 71 percent of the males and 76 percent of the females were testate, by 1931 88 percent of both males and females died testate.

At this time, IRS is working on ways to give outside researchers a means of access to this data base. But even though IRS is committed to making the data base accessible for research purposes, it recognizes the importance of preserving the confidentiality of the data source. The challenge is to give researchers a useful set of data which does not identify decedents or their heirs.

IRS is resolving these issues of access and confidentiality with the help of an advisory panel comprised of American and Canadian experts in such fields as economics, statistics, demography and sociology. These advisors come from both the private and public sectors, and are working on such topics as wealth estimation, demography and epidemiology, record matching methologies and confidentiality.

The advisors have already met at a series of workshops hosted by IRS and funded with a grant from the National Science Foundation. This funding source calls attention to the significance of estate tax returns for research in such areas as economics, sociology, demography and law. The more than 350,000 returns now on file in the data base together describe important changes in American society: its economy, population and social structure. This information will continue to be accessible to researchers without violating the confidentiality of the data source.

Coming Attractions

IRS has structured a long-term, in-house research program through which the Intergenerational Wealth data base is expanded and updated annually. IRS publishes tabulations of these data in its Statistics of Income Bulletin and elsewhere. The next installment in this series will feature information collected for the 1930 through 1945 period. As IRS continues to study the financial and demographic characteristics of wealthy decedents, estate planners will be able to see how their clientele has changed and how estate-planning practices have evolved. □

Some of the material in this article was published earlier by IRS in Medve, Kathy, "Estate Tax Returns Revisited, 1916-31," *SOI Bulletin*, Spring 1987, Internal Revenue Service, pp. 59-71, and Bentz, Mary, "The Intergenerational Wealth Study: Prospects for Data Analysis and Methodological Research," *Statistics of Income and Related Administrative Record Research*, 1986-1987, November 1987, Internal Revenue Service, pp. 61-67. The research is conducted under the supervision of Dr. Fritz Scheuren, director, Statistics of Income Division.

The authors wish to thank Sharon Virga, vice president of the National Association of Estate Planning Councils, for reviewing earlier drafts of this article.

The authors welcome questions or comments regarding this research and can be reached at the Internal Revenue Service, Statistics of Income Division, 1111 Constitution Avenue, N.W., Washington, D.C. 20224; Attention: Janet McCubbin TR:S:F.

FOOTNOTES

1. For a discussion of the "estate multiplier technique," see *Statistics of Income Supplemental Report, Personal Wealth 1962*, Internal Revenue Service, 1967, pp. 63-66.

2. For a discussion of probate practices in the overall U.S. population, see Shammas, Carole, et.al., *Inheritance in America: from Colonial Times to the Present*, New Brunswick, New Jersey, Rutgers University Press, 1987, pp. 179-181. Powell and Looker give an earlier account of estate planners and their wealthy clients; see Powell, R.R. and Looker, C., "Decedents' Estates: Illumination from Probate and Tax Records," *Columbia Law Review*, 1930, 7:939.

Janet McCubbin is an economist with the Statistics of Income Division of the Internal Revenue Service, where she studies various topics related to the distribution of income and wealth. The National Association of Estate Planning Councils is among the organizations to which she has spoken about estate tax data bases. She is a graduate of the University of Colorado.

Jeffrey P. Rosenfeld is consulting with IRS on the Intergenerational Wealth Study. He has written on the subject of inherited wealth for such magazines as *Psychology Today* and *American Demographics*. He is interested in ways that the aging of the U.S. population and changes in family structure are reshaping inheritance and estate plans.

TABLE I

Percentage of Estate Tax Decedents by Age and Sex, for Years of Death 1920 and 1931 and for Returns Filed in 1986

	1920		1931		1986	
Age Group	Males	Females	Males	Females	Males	Females
Under 60 years	28.0	20.0	24.6	15.7	15.0	4.9
60 to 69 years	27.7	23.7	29.0	22.8	25.2	11.6
70 years or more	44.3	56.3	46.4	61.5	59.8	83.6